



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Draft

Date Amended:	05/14/07	Bill No:	SB 359
Tax:	Sales and Use	Author:	Runner and Dutton
Related Bills:			

This analysis is limited to the sales and use tax provisions of this measure.

BILL SUMMARY

This bill would, among other things, exempt from sales and use tax those gross receipts in excess of \$1.66 per gallon on the sale or purchase of fuel and petroleum products to an air common carrier on a domestic flight, as specified, for the period January 1, 2008 until December 31, 2017.

SUMMARY OF AMENDMENTS

The amendments to this bill since the previous analysis increase the sales and use tax exemption for fuel purchases so that only the first \$1.66 per gallon, rather than the first \$1.88, would be subject to tax. In addition, the amendments delete the provisions that would have provided a partial exemption to specified purchases by new manufacturers and software producers, and that would have authorized certain motion picture income tax credits to be claimed as credits against sales and use tax paid.

ANALYSIS

CURRENT LAW

Under existing law, Section 6385 of the Revenue and Taxation Code provides a sales tax exemption for the sale of tangible personal property, *other than fuel and petroleum products*, sold to air, water, and rail common carriers when that property is shipped to a point outside this state under specified conditions. This section additionally provides a sales tax exemption for that portion of the sale of fuel and petroleum products sold to a *water* common carrier that remains on board after the water common carrier reaches its first out-of-state destination

With respect to air common carriers, Revenue and Taxation Code Section 6357.5 provides an exemption for the entire sales price of fuel and petroleum products sold to air common carriers when the fuel and petroleum products are for immediate consumption or shipment in the conduct of the air carrier's business on an international flight. Therefore, if an air common carrier's final destination were France, for example, current law would exempt the entire sale of fuel purchased in California, even if that carrier had stops in Los Angeles and New York before reaching its final destination. On the other hand, if the air carrier's final destination was somewhere in the United States, current law would impose tax on the entire sale of the fuel in California.

In addition to these exemptions, the law (Revenue and Taxation Code Sections 6366 and 6366.1) also contains an exemption for the sale and purchase or lease of aircraft to persons using the aircraft as a common carrier, and component parts of the aircraft as a result of the maintenance, repair, overhaul, or improvement of that aircraft in compliance with Federal Aviation Administration requirements, and any charges made for the labor and services rendered with respect to that maintenance, repair, overhaul, or improvement are exempt from tax.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.

PROPOSED LAW

This bill would add Section 6357.7 to the Sales and Use Tax Law to provide an exemption from January 1, 2008 until December 31, 2017 from the computation of the amount of tax on those gross receipts in excess of \$1.66 per gallon from the sale or purchase of fuel and petroleum products by an air common carrier on a domestic flight. If enacted, only the first \$1.66 per gallon would be subject to tax.

This bill defines the term “domestic flight” to mean a flight whose final destination is a point inside of the United States, including its territories.

This bill would also define the term “air common carrier” to mean a common carrier as defined in Section 23046 of the Business and Profession Code.

This bill would provide that the exemption does *not* apply to any tax levied pursuant to Bradley-Burns Uniform Local Sales and Use Tax Law and Transactions and Use Tax Law, unless approved by the local government that would otherwise receive the revenues derived from the taxes imposed under those laws.

As a tax levy, the bill would become effective immediately.

BACKGROUND

Until July 15, 1991, sales of fuel and petroleum products to air, water, and rail common carriers were exempt from sales tax when used in the conduct of the carriers’ common carrier activities after the first out-of-state destination. The rationale for this exemption was that it made California ports and airports more competitive, and it established consistency in the Sales and Use Tax Law for interstate and foreign commerce sales by exempting that portion of the fuel which was actually transported outside this state prior to any use. However, because of the budget crisis in 1991, this exemption was repealed by AB 2181 (Stats. 1991, Ch. 85) and SB 179 (Stats. 1991, Ch. 88).

In 1992, however, AB 2396 (Ch. 905) restored this exemption for fuel and petroleum products, but only with respect to water common carriers, and only until January 1, 1998. The sponsors of that measure, Pacific Merchant Shipping Association, successfully argued before the Legislature that the July 1991 repeal of the exemption had been directly responsible for a decline in the number of ships which bunker in California ports, and that reinstating the exemption would increase bunker activity in California. The sunset date of January 1, 1998 was extended until January 1, 2003 by AB 366 (Stats. 1997, Ch. 615). Subsequent legislation extended the sunset date to January 1, 2014 (Ch. 712, SB 808, Stats. 2003).

Two bills to restore the exemption for air and rail common carriers were introduced in the 1996 Legislative Session. AB 3375 (Olberg) would have restored the exemption for rail common carriers. AB 566 (Kaloogian) would have restored the exemption for air common carriers. According to a Department of Finance analysis of AB 566, “Governor Wilson has proposed a different form of tax relief for the aircraft industry. Under the Governor’s proposal, a sales tax exemption would be extended to property that becomes a component part of an exempt aircraft as a result of maintenance, repair, overhaul, or improvement of the aircraft in compliance with FAA requirements.” The Governor’s proposal was actually enacted in the 1996 Legislative Session by SB 38 (Lockyer, et al., Stats. 1996, Ch. 954) which, among other things, included the sales tax exemption for the component parts.

Four bills over the last decade have been introduced that would also have exempted from sales tax that portion of the sale of fuel and petroleum products sold to an air common carrier that is left on board after the air common carrier reaches its first out-of-state destination:

- AB 1800 (Machado, 1998) was held in the Assembly Appropriations Committee.
- AB 2470 (Wiggins, 2000) died in Assembly Revenue and Taxation Committee.
- SB 1510 (Knight, 2002) died in Senate Revenue and Taxation Committee.
- SB 998 (Margett, 2005) died in Senate Revenue and Taxation Committee.

Three other bills, similar to this bill, would have exempted from the sales and use tax, those gross receipts in excess of a specified amount per gallon on the sale or purchase of fuel and petroleum products by an air common carrier on a domestic flight:

- AB 2897 (Wiggins, 2002) would have exempted those gross receipts in excess of \$0.50 per gallon on the sale or purchase of fuel and petroleum products by an air common carrier. This bill was held in the Assembly Appropriations Committee.
- AB 236 (Bermudez, 2005) would have exempted those gross receipts in excess of \$0.632 per gallon on the sale or purchase of fuel and petroleum products by an air common carrier. This bill died in Assembly Revenue and Taxation Committee.
- SB 1619 (Dutton, 2006) would have exempted those gross receipts in excess of \$1.131 per gallon on the sale or purchase of fuel and petroleum products by an air common carrier. This bill died in the Senate Revenue and Taxation Committee.

COMMENTS

1. **Sponsor and Purpose.** This bill is sponsored by the author to create an exemption for sales of fuel to air common carriers since the exemption previously afforded to sales of fuel to air common carriers was repealed in 1991 due to budget constraints. The state's high tax rate, coupled with the excessive cost of fuel per gallon, is having a dramatic impact on the airline industry's activities in California.
2. **The May 14, 2007 amendments** delete the provisions that would have provided a partial exemption to specified purchases by new manufacturers and software producers, and that would have authorized certain motion picture income tax credits to be claimed as credits against sales and use tax paid. In addition, the amendments increase the exemption for fuel purchases so that only the first \$1.66 per gallon, rather than the first \$1.88, would be subject to tax.
3. **All air common carriers wouldn't be treated alike.** This bill defines an air common carrier by referencing Section 23046 of the Business and Professions Code. This section defines "air common carrier" to mean "a person engaged in regularly scheduled air transportation between fixed termini under a certificate of public convenience and necessity issued by the Civil Aeronautics Board, or its successor, or the Public Utilities Commission, or its successor, and 'airplane' or 'common carrier airplane' means an airplane operated in air transportation by an air common carrier." This definition is used in terms of the applicability of alcoholic beverage licensing laws to air common carriers selling distilled spirits on board airplanes operating in this State.

The Board, however, has defined “air common carrier” for purposes of the sales and use tax exemptions currently applicable to these persons through its Regulation 1621, *Sales to Common Carriers*. This regulation defines common carriers to include carriers such as those defined in this bill as well as other carriers, such as charter carriers, private carriers, or contract carriers, so long as they are engaged in the business of transporting persons or property for hire or compensation and offer these services indiscriminately to the public or some portion of the public. Is it appropriate to have two different definitions in law for the same term? This could add confusion in the proper reporting of those sales to carriers that remain subject to tax.

4. **The local government option, if exercised, would eliminate the uniform base of local and district taxes.** The bill would allow local governments to opt into the proposed exemption if they vote to do so. If no local governments opted into the proposed exemption, sales of fuel and petroleum products would be exempt at the rate of 6-1/4% (the state rate of 5-1/4%, the 1/2% Local Revenue Fund rate, and the 1/2% Local Public Safety Fund rate). All sales made within jurisdictions imposing a district tax would be subject to only the district tax rate.

However, if local governments opt into the exemption, California would be left with a variety of differing rates on sales of fuel and petroleum products. Some practical questions would arise as well. For example, if a city doesn’t opt into the exemption for its Bradley-Burns tax (1/2%), but a county does (3/4%), does the entire Bradley-Burns tax then go to the county within the city limits? That is, would the offsetting city credit disappear?

In addition to the likelihood of increased errors on sales and use tax returns, there would be an added burden placed on the retailers making the sales. The retailers receive no direct economic benefit from the proposed exemption, yet the retailers would be required to 1) program their computers to allow for a separate rate for the fuel sold to air carriers on a domestic flight versus all other fuel and petroleum product sales, 2) obtain and retain necessary documentation to support any exempt sales to qualifying carriers, and 3) account for the exempt sales for purposes of properly reporting their sales and use tax obligations to the Board.

Also, it is unclear whether “local government” would mean the people of the local jurisdiction voting on the measure or the governing body. Because one provision in the bill states the governing body allowing the exemption shall notify the Board, it would appear that the approval would be by the governing body, and not the local electorate. This should be clarified consistent with the author’s intent.

5. **The proposed definition of “domestic flight” and current law’s definition of “international flight” geographically overlap.** The bill would define “domestic flight” as a flight whose final destination is a point inside the United States, including its territories. Territories of the United States would include all of the following:

Guam	American Samoa
Midway Islands	Baker Island
Navassa Island	Federated States of Micronesia
Northern Mariana Islands	Howland Island
Palmyra Atoll	Jarvis Island
Puerto Rico	Johnston Atoll
U.S. Virgin Islands	Kingman Reef
Wake Island	

As stated earlier, current law (Section 6357.5) provides an exemption for the sale or purchase of fuel and petroleum products sold to air common carriers when the fuel and petroleum products are for immediate consumption or shipment in the conduct of the air carrier's business on an *international* flight. "International flight" is defined to mean a flight whose final destination is a point outside the United States. If enacted, these provisions would conflict, since the above territories are considered outside the United States. So, is it the author's intent that fuel purchased by an air common carrier for a flight that has a final destination to Guam be fully exempt as provided by current law, or partially exempt under the provisions of this bill?

COST ESTIMATE

Administrative costs would be incurred in notifying affected taxpayers, modifying tax returns, revising regulations and pamphlets, and answering inquiries from industry and the public. In addition, because of the potential for a partial tax exemption, with some local governments opting in on the exemption, administrative costs would also be incurred in computer programming, return analysis, and return processing.

REVENUE ESTIMATE

BACKGROUND, METHODOLOGY, AND ASSUMPTIONS

According to the U.S. Energy Information Administration, total sales of jet fuel in California for the year 2005 were 3.8 billion gallons. Approximately 10%, or 380 million gallons, of jet fuel sold in California is for military use. Therefore in 2005, 3.4 billion gallons (3.8 billion gallons – 0.38 billion gallons = 3.42 billion gallons) of jet fuel was used by commercial air carriers. According to the Bureau of Transportation Statistics, total gallonage consumed in the U.S. in 2005 was 19.3 billion. The fuel consumed by international flights accounts for 5.5 billion gallons, which comprises 28 percent (5.5 billion gallons / 19.3 billion gallons) of jet fuel consumed.

Currently, expenditures on fuel for international flights are exempt from sales and use tax. Assuming that jet fuel usage in California is consistent with the national average, the fuel used for domestic flights is 2.4 billion gallons (3.4 billion gallons x 72 percent = 2.4 billion gallons). As of May 4, 2007, the spot price of jet fuel in Los Angeles was \$2.129 per gallon. This bill would exempt that portion of the price over \$1.66 per gallon, or \$0.469 per gallon. Therefore, the total annual expenditures that qualify under this provision of the bill are estimated to be \$1.126 billion (2.4 billion gallons x \$0.469 per gallon = \$1.1 billion).

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Revenue Summary

The annual revenue loss from exempting \$1.126 billion in jet fuel sales in California is as follows:

Revenue Loss (in millions)

State (5.00%)	\$56.3
Fiscal Recovery Fund (0.25%)	2.8
Local Revenue Fund (0.5%)	5.6
Public Safety Fund (0.5%)	5.6
Total	\$ 70.3

Analysis prepared by: Sheila T. Waters (916) 445-6579 05/16/07

Revenue estimate by: Vanessa Shum (916) 445-0840

Contact: Margaret S. Shedd (916) 322-2376

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